Federal Assistance for Rural Housing Shifts Toward Loan Guarantees

Only since 1995 have loan guarantees outnumbered direct loans in USDA's main housing program (section 502), which assists in the purchase of single-family homes. The future of this and other housing programs includes tighter operating budgets, greater flexibility in use of funds, and more State and local government involvement.

Federal housing programs share with many other government programs the movement toward less government involvement and reduced expenditures. Funding reductions for housing programs are being accommodated by cuts in administrative expenses, revision or elimination of programs, reduction of subsidy levels, a shift to loan guarantees, and more stringent eligibility requirements. These cutbacks could be important for rural development, since housing is increasingly being promoted as a tool for economic and community development. In addition to Federal agencies' activities discussed later, two government-sponsored enterprises (GSE's), the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), are major players in home mortgage financing. (These GSE's and a recent initiative to increase their purchases of rural mortgages are discussed in the section on regulatory change.)

Fewer Rural Households Get Federal Housing Assistance

While a substantial minority of both rural and urban households benefit from Federal housing programs, rural households receive a smaller share. The 1993 American Housing Survey found that 17 percent of nonmetro and 25 percent of metro home mortgages were either from or insured by a Federal Government agency (fig. 1).

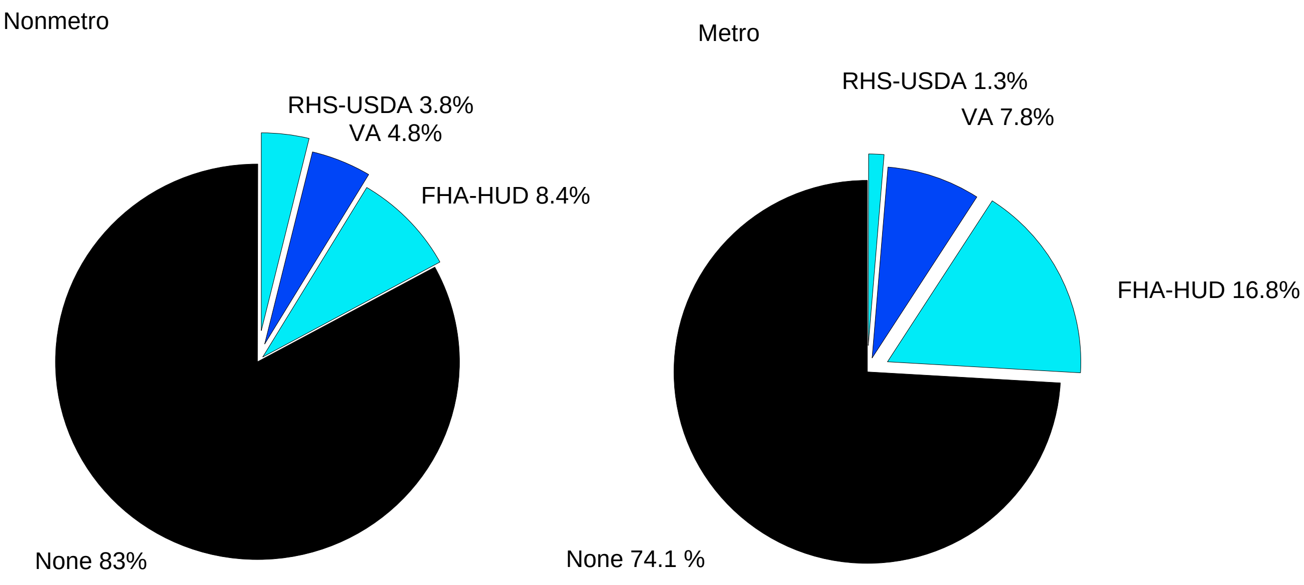
Federal programs emphasize homeownership, primarily using guaranteed/insured loans from private lenders rather than direct loans. Although direct lending under USDA section 502 is still larger than any other direct Federal mortgage lending program, and its level is still substantial, a majority of section 502's new activity comes from loan guarantees.

Other major Federal mortgage programs provide even more loan guarantees in nonmetro areas than USDA's section 502 program, which is targeted at persons with no more than moderate incomes for the purchase of modest housing. For example, in fiscal year 1994 section 502-guarantee activity averaged under $7 per nonmetro person, compared with

Figure 1

Federal agencies and home mortgage lending, 1993

Smaller share of rural lending is Federally insured or direct



Source: ERS tabulations from American Housing Survey for the United States, 1993.

$94 for single-family home loans insured by the Federal Housing Administration (FHA). Rural loans insured by the Department of Veterans Affairs (VA) were $35 per capita. These rural per capita amounts were only one-fourth of the urban level for FHA loans and half of the urban level for VA loans.

The amount of subsidy for new mortgage lending has dropped with the decline in direct loans, which usually employ such subsidy tools as reduced transaction charges, below-market interest rates, and relaxed lending standards, including smaller downpayment requirements. The subsidy costs of direct loans have also been lowered through lending at higher interest rates, recapturing prior subsidies, and charging lending fees.

While on a per capita basis urban areas receive more Federal funds for rental housing than do rural areas, the difference is much less for homeowner programs. In fiscal year 1994, the largest programs for rental housing provided about $96 per capita in urban and $68 per capita in rural areas. While owner programs have a clientele base across a broad income spectrum, renter programs are almost exclusively focused on the low-income population. Renter programs operate by either subsidizing rents for those unable to afford adequate housing or by promoting an increased supply of low-cost rental housing. Both approaches can be found in a single program, for instance when construction or financing costs are subsidized in return for an agreement that units be rented to program participants at reduced rates. Federal housing subsidies that are tied to particular rental units for a long period of time are being slowly replaced with more flexible tenant assistance. Programs are placing more emphasis on housing vouchers, local control, and homeownership.

USDA Emphasis Is on Home Ownership

USDA's housing programs are administered by the Rural Housing Service (RHS), which was created out of the Farmers Home Administration in a 1994 departmental reorganization. RHS housing programs provide assistance to rural populations in both nonmetro and metro counties. The largest RHS housing program is section 502 single-family housing, which constitutes about three-fourths of the agency's housing loan activity. New RHS lending in fiscal year 1994 split about equally between purchasers of rural homes in nonmetro (49 percent) and metro (51 percent) areas. Nonmetro counties with higher per capita levels of these loans were concentrated in New England, parts of the Mountain West, and scattered across the Midwest and Southeast (fig. 2). The section 502 program has experienced considerable change in the last 2 years. More new loans are now made under a section 502 loan guarantee authority, initiated in 1992. USDA section 502 direct lending for fiscal year 1996 will be $410 million, about 40 percent below that of 1994. However, section 502 lending will be higher in 1996 than 1995, with increases in both direct and guaranteed lending. Section 502 guaranteed lending is expected to be $680 million in fiscal year 1996, up 53 percent from a year earlier. For various reasons, through fiscal year 1995, subsidies provided to section 502 borrowers fell annually for several years. Direct loans are nearly all made at subsidized interest rates, while all guaranteed loans are at market rates. Total subsidy expenses on new loans fell not only from the smaller number of loans carrying an interest subsidy, but also from declines in market interest rates and changes in program regulations that generally lowered subsidy levels. The fiscal year 1996 combination of increased direct lending and higher conventional interest rates probably reversed this trend, with section 502's subsidy expense above its fiscal year 1995 level. A major change planned for fiscal year 1998 aims to save on costs, mostly by lowering administrative expenses.

The RHS administers other housing programs for the same rural areas eligible for the section 502 program. The largest of these activities involve financing for the construction or purchase of low-income rental housing and rental assistance for low-income tenants. Nonmetro areas received about $12 per person through these rental programs in fiscal year 1994, compared with $21 for section 502. RHS's total loan and grant activity for fiscal year 1996 is estimated to be 77 percent section 502, 20 percent rental programs, and

3 percent for other programs. Included in the last group are such activities as self-help housing, farm-labor housing, and very-low-income housing repair.

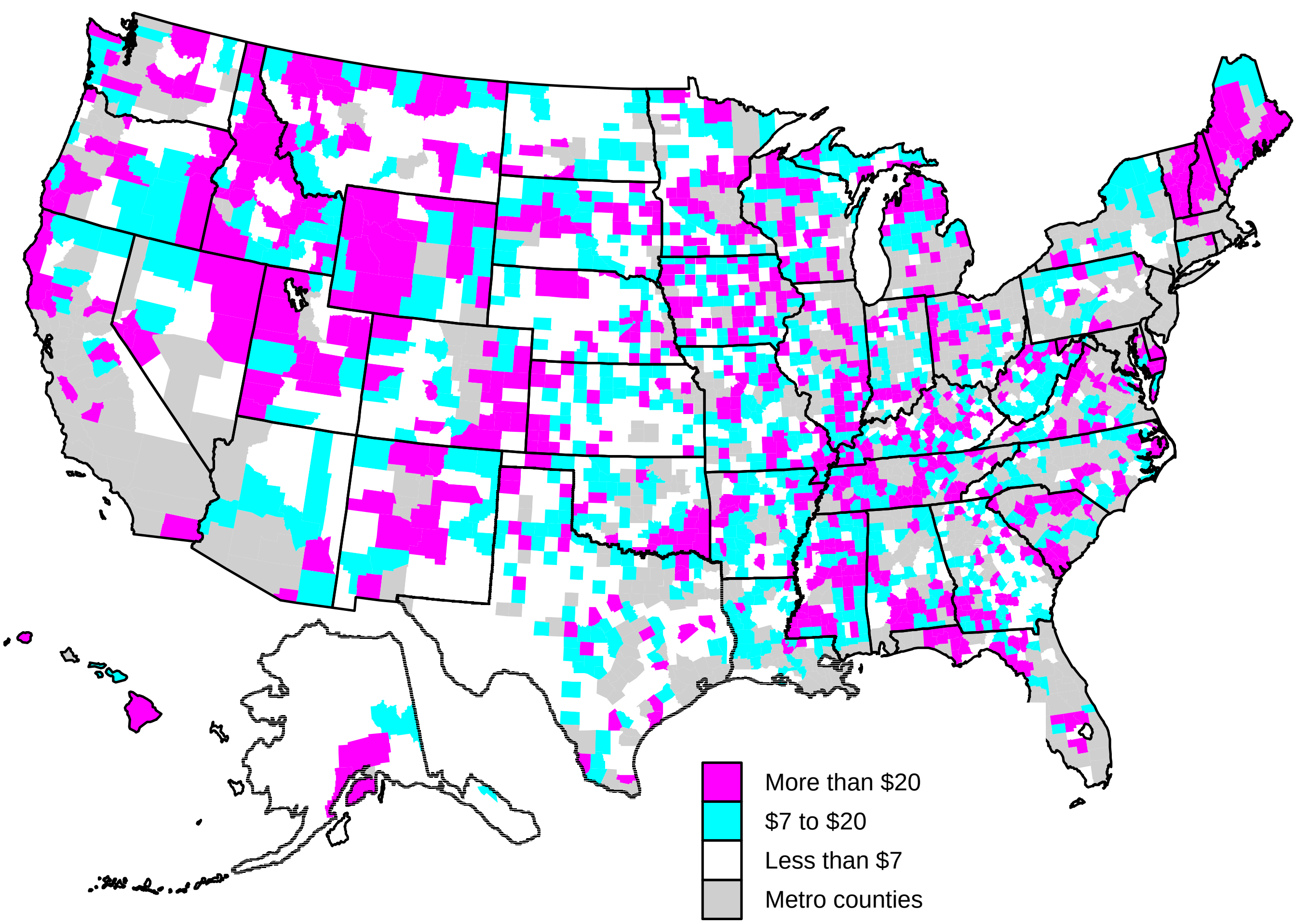
FHA Insurance Dominates HUD Housing Programs

HUD's main housing program is FHA's home mortgage insurance program, which provided $48.5 billion of mortgage insurance in fiscal year 1995. About 5 percent of the amount insured in fiscal year 1994 was in nonmetro areas. On a per capita basis, nonmetro residents received only about one-fourth as much as did metro residents. The largest housing program financed by direct outlays or grants was HUD's $17.5-billion section 8 low-income housing assistance program, of which rural areas received 13 percent. This program is undergoing substantial change as HUD's housing strategy moves away from long-term financing commitments. The next largest housing expenditure in fiscal year 1995 was HUD's $3.7-billion public housing capital fund, with a rural share of 17 percent. Per capita expenditures of this program were only slightly lower in nonmetro than metro areas, $13 and $15, respectively. The highest per capita levels of nonmetro activity were in the South and Southeast (fig. 3).

Figure 2

Per capita USDA nonmetro single-family housing loans, fiscal year 1994

USDA home ownership programs are more important in scattered rural counties of the Midwest and Southeast, with concentrations in New England and the Mountain West



Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

The future of HUD and its programs has not been determined as of this date, but major changes are in the works. Programs in the future HUD seem destined to be many fewer in number and much more flexible in how they are used. State and local governments will have much more control over what will likely be a reduced level of funding.

VA Loan Programs

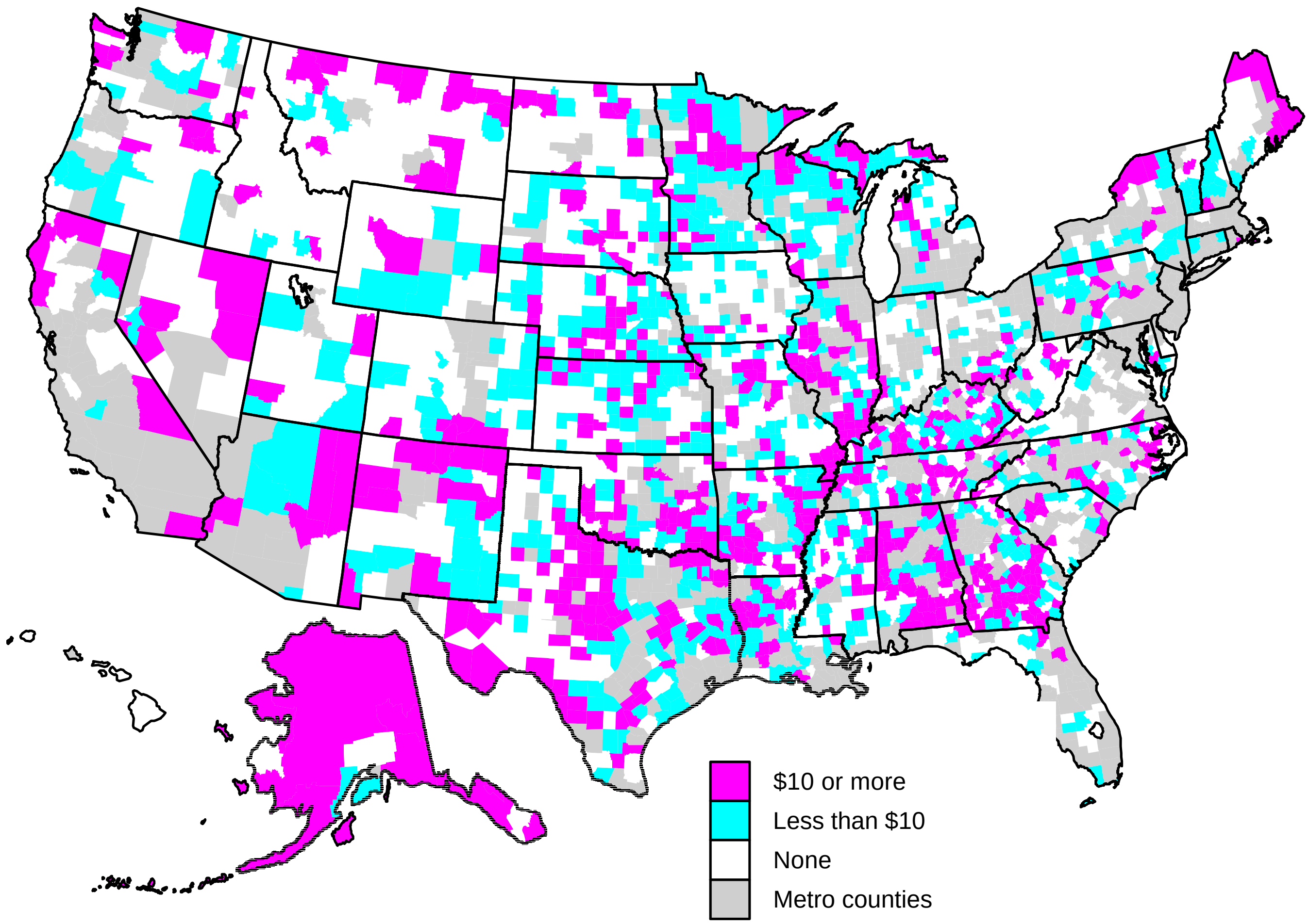
VA housing loans are expected to total about $33 billion in fiscal year 1996, up $4 billion from 1995, but more than $12 billion below the 1994 level. About 10 percent of VA's housing program activity is in nonmetro areas. Nearly all of that is in the form of guarantees on loans from private lenders. These guarantees cover loan losses that may be as much as 50 percent, but sometimes less than 25 percent, of the loan amount.

At one time, the typical VA loan was available with no fee to the borrower, but now borrowers usually pay a fee that is a percentage of the loan amount. Fees are higher for certain loans, including those with smaller down payments. Some special borrowers can receive the loan guarantee at no cost. In the past, VA regulations targeted direct loans to "rural areas where availability of private mortgage funds was limited." This is no longer true. Direct loans are now restricted to financing specially adapted housing assistance for certain disabled veterans. *[Jim Mikesell, 202-219-0098, mikesell@econ.ag.gov]*

Figure 3

Per capita funding for nonmetro public housing, fiscal year 1994

Public housing expenditures are more important for rural counties in the South and Southeast plus areas with Native American concentrations



Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.